

Remarks to Charter Revision Committee

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June 22, 2007

I am delighted to appear before you to give you my thoughts on certain aspects of your mission regarding charter revision from my perspective as the City's Independent Consultant and Monitor. You have a critical role to play in charting the City's future and restoring its credibility after a period of great difficulty.

I see each of our assignments as related and complementary. I am serving as Independent Consultant under the City's SEC Enforcement Order and as Independent Monitor in connection with the Kroll Report recommendations. As such, my responsibilities are to assist the City to put in place the structures, procedures, policies and controls designed to produce reliable and quality disclosure and financial reporting and to report on the City's progress and its compliance with legal requirements. I recently issued my Initial Report which identifies several areas in which this Committee plays a critical role. It is those I will discuss.

First, let me identify a few broad principles that come out of the Kroll Report and my observations that I believe are relevant to your work:

- There needs to be focused responsibility for management of the City, especially with respect to financial matters, so that there can be clear accountability. This requires clear lines of authority and the necessary resources to do the job. The absence of this focused responsibility accounts, in part, for the past compliance failures.
- There needs to be the proper checks and balances and control structures to ensure the adequacy and propriety of the work being done and compliance with legal requirements.
- Although checks and balances are important, we must remember that the ultimate objective of City government is to effectively operate the City for the benefit of its citizens. Checks and balances and control systems are a means of assuring that this objective is met in full compliance with law but are not ends in themselves.

A few other general thoughts:

- The Kroll Report recommendations form a roadmap for the City to follow in achieving necessary remediation. A roadmap is essential to charting the course and direction but like any roadmap there can be detours and variations when a better route exists or becomes apparent.
- There are many models, sources of recommendations and examples from elsewhere and, although they can be useful, they should not be followed by rote both because

there are acceptable variations and particular situations differ. Thus, the City's particular situation, culture and working relationships need to be evaluated. Moreover, the right structure cannot be looked at piecemeal but rather should be viewed as a whole, taking into account how the various pieces fit together.

- Last, there is no definitive precedent to follow because in many ways what the City is trying to do is unique. Having become the poster child for compliance deficiencies in the municipal sector, it now has the opportunity to become a model in a post-Sarbanes Oxley environment to translate the lessons learned in the corporate world regarding the importance of governance, processes and controls to the municipal world.

To get to specifics in areas that relate to my role and responsibilities:

- ***Establishing an Audit Committee to provide independent oversight of financial matters.*** Independent oversight of financial management is a critical component of an effective control structure and legal compliance program. The key is requisite independence from management and financial expertise. There are a number of models, with most focusing on the committee being drawn from the legislative body, which is separate from management – the executive. This model has the advantage of independence from management but the disadvantage of not necessarily assuring sufficient financial expertise.

The arrangement currently in place pending Charter revision is described in my Report and has much to recommend it, although it can be improved upon. My view is that the Audit Committee should be structured so that it can be viewed as a committee of the City Council. If one thinks of the Council's role as a legislative body, with responsibilities over budgetary and fiscal matters and with a role in approving the City's offering disclosure, including its financial statements, it is useful for it to be able to look to its committee as having been involved through its oversight role in the process of preparation of the financial statements. At the same time, the Audit Committee should have accounting and auditing expertise. Thus, I believe a combination of Council members and citizens with accounting and auditing expertise is optimal. To be effective, the citizens need to be full members, sitting at the table with equal authority and responsibility.

The precise makeup can be debated. My own view, on balance, is that the Audit Committee should consist of three Council members, one of whom should be chair, and two citizen members. One citizen member could be appointed by the Committee (or the Council) and the other by the Mayor, in each case for their expertise. Alternatively, if greater balance is viewed as desirable, both citizen members could be appointed by the Mayor. A flip in the Committee's makeup to two Council members and three citizens would also be acceptable if there were reasons for doing so.

- ***Establishing an effective and independent internal audit function.*** This is a critical component of a reliable control structure. The present interim arrangement in compliance with the current City Charter provisions is described in my Report. The

Charter should be revised to separate out from the Auditor and Comptroller office a separate position of Internal Auditor. (I prefer this name to Auditor General as recommended by the Kroll Report for reasons I explain.) There are several models ranging from a dual reporting model to a separate inspector general-type auditor, either appointed or elected. My own view, based upon the corporate model and my observations regarding the existing separate bodies within the City government, is that a dual reporting model under which the Internal Auditor is a part of management for administrative purposes but has direct reporting responsibility to the Audit Committee as the independent oversight body is best designed to accomplish both effective operation and the required independence. At the end of the day, the different bodies within the City need to be able to work together.

Consistent with a dual reporting model, I would have the Internal Auditor selected by the Mayor and approved by the Audit Committee (or the Council). The person would have to meet minimum professional standards including being subject to professional independence standards. The person should have a long-term contract to ensure job security and should be subject to dismissal with the approval of both the Mayor and the Audit Committee. The internal audit budget and annual work plan should be developed by the Internal Auditor in consultation with management and approved by the Audit Committee. There are further details designed to ensure independence that can be fleshed out.

- ***Ensuring that there is focused responsibility and corresponding accountability within the City's governmental structure.*** As I indicated, the failures of the past were, in part, attributable to the absence of clear lines of authority, responsibility and accountability. This leads me to a couple of observations: (1) the City is best served by a strong Mayor form of government, with appropriate checks and balances; and (2) the Charter should clearly recognize the position of Chief Financial Officer with responsibility over financial matters, and this position should be the same as the one currently designated Auditor and Comptroller to avoid bifurcation of responsibility. This is based upon the internal audit function being separated out as a new position of Internal Auditor. As a result, it would be desirable, to avoid confusion, to rename the position "Auditor and Comptroller" (perhaps "Chief Executive Officer and Comptroller").

I hope this has been helpful to you. There is a great opportunity to reestablish the City's credibility, to build a structure that will work for years to come and to create a model for others to emulate. I am happy to answer any questions.